

UNITED STATES BANKRUPTCY COURT
DISTRICT OF HAWAII

In re

HALEKUA DEVELOPMENT
CORPORATION,

Debtor.

Case No. 03-01279
Chapter 7

Re: Docket No. 568

MEMORANDUM OF DECISION ON
MOTION TO APPROVE SETTLEMENT

The trustee has moved for authority to enter into a proposed settlement with Kunia Residential Partners (“KRP”) (docket no. 568). Under the settlement, the trustee would pay \$1,000,000 to KRP in exchange for a release of all claims, including a claim of over \$4,000,000 which KRP asserts is entitled to administrative priority.

The trustee argues that the settlement is fair and reasonable. He also points out that the KRP claim is the last unresolved claim in this case. Approval of the settlement would clear the way for full payment of all remaining prepetition unsecured claims and the closing of this six year old case.

The holder of the equity interest in the estate, Canyon Capital Real Estate Advisors, LLC and related entities (“Canyon”), objects to the settlement. Canyon argues (in summary) that KRP has no legitimate claims and that the proposed

settlement would wipe out the equity distribution to which Canyon is entitled.

For the following reasons, I will grant the trustee's motion.

Canyon first argues that the trustee cannot settle the KRP claim without Canyon's consent. Canyon cites nonbankruptcy cases for the proposition that a settlement between the original plaintiff and the defendants cannot extinguish the claims of intervenors without the intervenors' concurrence. Local Number 93, Int'l Assoc. of Firefighters, etc. v. City of Cleveland, 478 U.S. 501, 529 (1986). Canyon cites no case, however, for the proposition that a bankruptcy trustee cannot settle a claim against the estate without the equity holder's consent. The principle cited by Canyon, if extended to the bankruptcy context, would undercut the trustee's position as "the representative of the estate," 11 U.S.C. § 323(a) (emphasis added), and would put unwarranted roadblocks in the claims objection process. Canyon undoubtedly has standing to object to claims and settlements of claims, but neither Canyon nor any other party can simply veto the trustee's recommendations to the court.

Canyon also argues that the proposed settlement is too generous to KRP because (according to Canyon) KRP has no meritorious claims.

A bankruptcy court must make an "independent evaluation" that a proposed settlement is fair and equitable to creditors and is in the estate's best interest. In re

A & C Properties, 784 F.2d 1377, 1381 (9th Cir. 1986), overruled on other grounds by In re Washington Public Power Supply System Sec. Litigation, 823 F.2d 1349 (9th Cir. 1987).

It is clear that there must be more than a mere good faith negotiation of a settlement by the trustee in order for the bankruptcy court to affirm a compromise agreement. The court must also find that the compromise is fair and equitable. In determining the fairness, reasonableness and adequacy of a proposed settlement agreement, the court must consider:

(a) The probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.

Id. (citations and internal quotations omitted). The bankruptcy judge's job is "not to decide the numerous questions of law and fact . . . but rather to canvass the issues and see whether the settlement falls below the lowest point in the range of reasonableness." In re W.T. Grant Co., 699 F.2d 599, 608 (2d Cir. 1983), cert. denied, 464 U.S. 822 (1983) (citations and internal quotations omitted).

Collection Issues

This dispute involves a claim against the estate, not a claim against a third party. No "difficulties" will be "encountered in the matter of collection."

Opinions and Interests of Creditors

Although several unsecured creditors objected when KRP filed a motion for payment of its alleged administrative claim, no unsecured creditor has objected to the proposed settlement, and one has joined in the motion.

Canyon objects vociferously to the settlement. Its views are entitled to consideration, but the fact that its claims are junior to those of the unsecured creditors reduces the weight of its views.

The interests of the parties explain their varying opinions. If the settlement is approved, the prepetition unsecured creditors will be paid promptly and in full. If the KRP claims are litigated rather than settled, however, all distributions would be delayed, and the distributions might be reduced if KRP prevailed. Stated differently, the prepetition unsecured creditors have nothing to gain and much to lose if the settlement is rejected. Canyon is in the opposite position: Canyon probably will get nothing if the settlement is approved and might get something if the litigation is successful. Canyon therefore has everything to gain and nothing to lose if the settlement is rejected.

If the matter were litigated, nearly all the risk would fall on a senior class of claimants and all of the potential reward would flow to a junior class. This unfair allocation of risks and rewards counts in favor of the proposed settlement.

Complexity of the Litigation

KRP's claims arise out of multiple, complex, pre- and post-petition agreements made during the course of two decades.

Prior to 1992, the debtor, Halekua Development Corporation ("HDC"), owned a large tract of land which it wished to develop as a project called "Royal Kunia." In 1992, HDC and Castle & Cooke Kunia, Inc. ("CCKI"), formed a limited partnership called Kunia Residential Partners ("KRP"). CCKI was the general partner and HDC was the limited partner of KRP. HDC sold a portion of the Royal Kunia property, called "Royal Kunia Phase I," to KRP, and HDC kept the remaining adjacent property, called "Royal Kunia Phase II." Under the partnership agreement and related agreements, KRP agreed to build infrastructure on the Royal Kunia Phase I property with sufficient capacity to serve the Royal Kunia Phase II property as well. HDC agreed to reimburse KRP for specified percentages of the cost of the Royal Kunia Phase I infrastructure.

KRP developed the Royal Kunia Phase I property and completed most, but not all, of the Royal Kunia Phase I infrastructure as agreed. HDC did not, however, reimburse KRP for its share of the cost.

HDC obtained governmental approvals to develop the Royal Kunia Phase II property with deadlines attached. When HDC failed to meet the development

timetable, the authorities threatened to revoke their approvals. On April 25, 2003, HDC filed a chapter 11 petition, in order to stave off this danger.

On April 15, 2004, after HDC's efforts to obtain new financing failed, I converted the case to chapter 7. After extensive negotiations, the trustee and the secured creditors, including KRP, agreed on a procedure for an auction sale of the real property and most of the estate's other assets (but not HDC's limited partnership interest in KRP).

At the auction, the case took an unusual turn. HDC, as debtor out of possession, made the highest bid of \$50,200,000. HDC obtained financing from Canyon and others (which new financing was not a claim against the estate or the trustee). To secure the new financing, the lenders took liens against the purchased assets and HDC's rights in this bankruptcy case, including its right to receive any surplus after payment of all creditor claims.

After further negotiations and disputation, the transaction closed on March 12, 2007, and the trustee received net proceeds (after payment of closing costs and secured claims) of almost \$4.8 million.

Upon (and as a condition of) closing, HDC, as purchaser and debtor out of possession, entered into a Connection Agreement with KRP. In summary, the Connection Agreement provides that, if KRP's secured claim were paid in an

agreed amount, KRP would permit HDC to connect to the Phase I infrastructure and that KRP and HDC would each construct certain recreational facilities. The trustee is not a party to the Connection Agreement and the agreement is not a contractual obligation of the estate.

After closing, the trustee addressed the tax implications of the sale and objected to claims that he believed lacked merit. The tax issues have been resolved and the claims allowance process has been completed (but for KRP's claim).

In the meantime, HDC defaulted in its obligation to repay its new financing. Canyon elected to foreclose and has become the owner of the equity interest in this estate.

On January 30, 2009, almost two years after the sale closed, and just before the last prepetition unsecured claim was resolved, KRP filed a motion for payment of an alleged administrative expense. KRP contends that, by entering into the post-petition Connection Agreement, KRP made it possible for the trustee to sell the estate's property at a favorable price, and that this benefit to the estate entitled KRP to administrative status for its claim.

Canyon objects to KRP's administrative claim, contending (in summary) that KRP's new claim comes too late, particularly because Canyon relied on KRP's prior claims in calculating the likely surplus in the estate which was part of

its collateral, and that KRP's claim is at best a prepetition claim arising out of the partnership agreement and related agreements. The trustee objects on similar grounds.

Litigating the claim would be relatively complex and time consuming. The parties have already filed hundreds of pages of memoranda, declarations, and exhibits. The factual record covers a period of seventeen years. Some of the legal issues, such as whether the prepetition partnership agreement and related agreements are executory contracts and the status of claims arising out of those agreements, are fairly complex. Many of the grounds for the objections, such as waiver, estoppel, and laches, are fact intensive and might require an evidentiary hearing. Because a significant amount of money is at stake, Canyon and KRP would probably continue to litigate vigorously. Approval of the settlement might not terminate the litigation altogether (for example, Canyon might appeal), but it would probably narrow and shorten the litigation substantially.

Probability of Success in the Litigation

To evaluate a settlement, it is not necessary to conduct a "mini-trial" on the merits of the claims being compromised. In re Blair, 538 F.2d 849, 853 (9th Cir. 1976). The court need not rule on any disputed questions of law or fact, "but rather only canvass the issues." Burton v. Ulrich (In re Schmitt), 215 B.R. 417,

423 (B.A.P. 9th Cir. 1997).

It seems unlikely that KRP could establish an administrative claim against the estate. The post-petition Connection Agreement cannot create an administrative liability because neither the trustee nor the estate are party to it. KRP argues that the Connection Agreement benefitted the estate by making the real property more saleable, but KRP offers no authority for the startling proposition that one who makes a contract with a third party has a viable claim against a non-party to the contract for any incidental benefits flowing from the contract.

It may not matter, however, whether KRP's claim is entitled to administrative priority, because there are funds available for distribution to nonpriority unsecured claimants. KRP has at least a reasonable argument that it has a prepetition claim against the estate for reimbursement of these expenses under the prepetition partnership agreement and related agreements. The Allocation Agreement requires HDC to bear fifty percent of the cost of the "Kunia Interchange and Offramp Improvement" and the "Recreation Center."¹

Canyon, the trustee, and the other creditors have pointed out that KRP

¹Canyon argues that KRP cannot recover the expense of the recreation center because KRP has not yet built the center and incurred the expense. As a matter of contract law, however, a party can recover future damages that can be proven with sufficient certainty.

asserted this claim very late in the proceedings, well after the bar date for prepetition claims. KRP responds that its timely filed proofs of claim reserved KRP's right to assert claims for additional amounts. Therefore, the new amounts claimed by KRP are at least arguably covered by KRP's timely proofs of claim.

Moreover, even if KRP's claim is tardy, KRP would still be entitled to a distribution on the claim after payment of all timely claims and before Canyon receives any surplus. 11 U.S.C. § 726(a)(3), (6). The remedy for a tardy claim is subordination, not disallowance. See Heath v. Am. Express Travel Related Servs. Co. (In re Heath), 331 B.R. 424, 434 (B.A.P. 9th Cir. 2005) (a claim is allowed unless "one of the limited grounds for disallowance is established. 11 U.S.C. § 502(b).")


Therefore, there is a reasonable chance that KRP could establish a claim that has priority over Canyon.

* * *

Considering all relevant factors, I find and conclude that the settlement is fair and equitable, and that it falls well within the range of reasonableness. I take additional comfort in the fact that an experienced trustee, represented by experienced counsel, has also decided that the settlement is appropriate. In re Blair, 538 F.2d at 851 (stating the bankruptcy judge may give weight to the

opinions of the trustee when approving a settlement agreement).²

Counsel for the trustee is directed to submit an appropriate separate judgment.

 **/s/ Robert J. Faris**
United States Bankruptcy Judge
Dated: 09/25/2009

²It is also significant that Canyon initially offered to prosecute the objection at no expense to the estate. When KRP offered the settlement, the trustee concluded (and I agree) that KRP's proposal was more beneficial to the estate than Canyon's. Canyon has not made a better proposal. Goodwin v. Mickey Thompson Entm't Group, Inc. (In re Mickey Thompson Entm't Group, Inc.), 292 B.R. 415 (B.A.P. 9th Cir. 2003) .